

(B) *Ratable portion—(1) Dispositions on which gain is recognized.* The ratable portion of any gain from the disposition of an interest in a passthrough entity that is allocable to an activity described in paragraph (e)(3)(ii)(A) of this section is determined by multiplying the amount of such gain by the fraction obtained by dividing—

(i) The amount of net gain (within the meaning of paragraph (e)(3)(ii)(E)(3) of this section) that would have been allocated to the holder of such interest with respect thereto if the passthrough entity had sold its entire interest in such activity for its fair market value on the applicable valuation date; by

(ii) The sum of the amounts of net gain that would have been allocated to the holder of such interest with respect thereto if the passthrough entity had sold its entire interest in each appreciated activity (within the meaning of paragraph (e)(3)(ii)(E)(1) of this section) described in paragraph (e)(3)(ii)(A) of this section for the fair market value of each such activity on the applicable valuation date.

(2) *Dispositions on which loss is recognized.* The ratable portion of any loss from the disposition of an interest in a passthrough entity that is allocable to an activity described in paragraph (e)(3)(ii)(A) of this section is determined by multiplying the amount of such loss by the fraction obtained by dividing—

(i) The amount of net loss (within the meaning of paragraph (e)(3)(ii)(E)(4) of this section) that would have been allocated to the holder of such interest with respect thereto if the passthrough entity had sold its entire interest in such activity for its fair market value on the applicable valuation date; by

(ii) The sum of the amounts of net loss that would have been allocated to the holder of such interest with respect thereto if the passthrough entity had sold its entire interest in each depreciated activity (within the meaning of paragraph (e)(3)(ii)(E)(2) of this section) described in paragraph (e)(3)(ii)(A) of this section for the fair market value of each such activity on the applicable valuation date.

(C) *Default rule.* If the gain or loss recognized upon the disposition of an

interest in a passthrough entity cannot be allocated under paragraph (e)(3)(ii)(A) of this section, such gain or loss shall be allocated among the activities described in paragraph (e)(3)(ii)(A) of this section in proportion to the respective fair market values of the passthrough entity's interests in such activities at the applicable valuation date, and the gain or loss allocated to each activity of the passthrough entity shall be treated as gain or loss from the disposition of an interest in such activity.

(D) *Special rules.* For purposes of this paragraph (e)(3)(ii), the following rules shall apply:

(1) *Applicable valuation date—(i) In general.* Except as otherwise provided in paragraph (e)(3)(ii)(D)(1)(ii) of this section, the applicable valuation date with respect to any disposition of an interest in a passthrough entity is whichever one of the following dates is selected by the passthrough entity:

(a) The beginning of the taxable year of the passthrough entity in which such disposition occurs; or

(b) The date on which such disposition occurs.

(ii) *Exception.* If, after the beginning of a passthrough entity's taxable year in which a holder's disposition of an interest in such passthrough entity occurs and before the time of such disposition—

(a) The passthrough entity disposes of more than 10 percent of its interest (by value as of the beginning of such taxable year) in any activity;

(b) More than 10 percent of the property (by value as of the beginning of such taxable year) used in any activity of the passthrough entity is disposed of; or

(c) The holder of such interest contributes to the passthrough entity substantially appreciated property or substantially depreciated property with a total fair market value or adjusted basis, respectively, which exceeds 10 percent of the total fair market value of the holder's interest in the passthrough entity as of the beginning of such taxable year;

then the applicable valuation date shall be the date immediately preceding the date on which such disposition occurs.

(2) *Basis adjustments.* Any adjustment to the basis of partnership property under section 743(b) made with respect to the holder of an interest in a partnership shall be taken into account in computing the net gain or net loss that would have been allocated to the holder with respect to such interest if the partnership had sold its entire interest in an activity.

(3) *Tiered passthrough entities.* In the case of a disposition of an interest in a passthrough entity (the "subsidiary passthrough entity") by a holder that is also a passthrough entity, any gain or loss from such disposition that is taken into account by any person that owns (directly or indirectly) an interest in such holder shall be allocated among the activities of the subsidiary passthrough entity by applying the rules of this paragraph (e)(3)(ii) to the person taking such gain or loss into account as if such person has been the holder of an interest in such subsidiary passthrough entity and had recognized such gain or loss as a result of a disposition of such interest.

(E) *Meaning of certain terms.* For purposes of this paragraph (e)(3)(ii)—

(I) An activity is an appreciated activity with respect to a holder that has disposed of an interest in a passthrough entity if a net gain would have been allocated to the holder with respect to such interest if the passthrough entity has sold its entire interest in such activity for its fair market value on the applicable valuation date;

(2) An activity is a depreciated activity with respect to a holder that has disposed of an interest in a passthrough entity if a net loss would have been allocated to the holder with respect to such interest if the passthrough entity had sold its entire interest in such activity for its fair market value on the applicable valuation date;

(3) The term "net gain" means, with respect to the sale of a passthrough entity's entire interest in an activity, the amount by which the gains from the sale of all of the property used by (or representing the interest of) the passthrough entity in such activity exceed the losses (if any) from such sale;

(4) The term "net loss" means, with respect to the sale of a passthrough entity's entire interest in an activity, the amount by which the losses from the sale of all of the property used by (or representing the interest of) the passthrough entity in such activity exceed the gains (if any) from such sale.

(iii) *Treatment of gain allocated to certain passive activities as not from a passive activity.* If, in the case of a disposition of an interest in a passthrough entity—

(A) An amount of gain recognized on account of such disposition by the holder of such interest (or any other person that owns (directly or indirectly) an interest in such holder if such holder is a passthrough entity) is allocated to a passive activity of such holder (or such other person) under paragraph (e)(3)(ii) of this section;

(B) [Reserved] See § 1.469-2(e)(3)(iii)(B) for rules relating to this paragraph.

(C) The amount of the gain of the holder (or such other person) described in paragraph (e)(3)(iii)(B) of this section exceeds 10 percent of the amount of the gain of the holder (or such other person) described in paragraph (e)(3)(iii)(A) of this section;

then the gain of the holder (or such other person) that is described in paragraph (e)(3)(iii)(A) of this section shall be treated as gain that is not from a passive activity to the extent that such gain does not exceed the amount of the gain of the holder (or such other person) described in paragraph (e)(3)(iii)(B) of this section. For purposes of applying the preceding sentence to the disposition of an interest in a partnership, the amount of gain that would have been allocated to the holder (or such other person) if all of the property used in an activity had been sold shall be determined by taking into account any adjustment to the basis of partnership property made with respect to such holder (or such other person) under section 743(b).

(iv) *Dispositions occurring in taxable years beginning before February 19, 1988—*(A) *In general.* Except as otherwise provided in this paragraph (e)(3)(iv), if the holder of an interest in a passthrough entity sells, exchanges, or otherwise disposes of all or part of